IN THE DISTRICT COURT OF THE THIRD JUDICIAL DISTRICT

IN AND FOR SALT LAKE COUNTY, STATE OF UTAH

UTAH CAPITAL INVESTMENT CORP.	:	**RULING AND ORDER**
Plaintiff,	:	**CASE NO. 040923031**
vs.	:	**May 20, 2005**
UTAH CAPITAL INVESTMENT BOARD., et al.	:	
Defendants.	:	

The above matter came before the Court on May 18, 2005, for oral argument on the parties' cross-motions for summary judgment, pursuant to Rule 7. Plaintiff, Utah Capital Investment Corporation ("the Corporation") was present through Mark Gaylord and Angela W. Adams, Defendant Utah Capital Investment Board ("the Board") was present through Jerrold S. Jensen, and Defendant Auston G. Johnson (Johnson) was present through Thom D. Roberts.

Plaintiff filed its Motion for Summary Judgment with accompanying memorandum on January 27, 2005, to which Defendant Board responded on March 7, 2005. Defendant Johnson filed a cross-motion, also with accompanying memorandum on March 18, 2005. Plaintiff filed its joint reply in support of its motion and in opposition to Johnson's motion on April 8, 2005. Defendant Johnson

filed his reply on April 18, 2005 and Plaintiff submitted the matters for decision on April 19, 2005. The court scheduled oral argument.

Having considered the case file, the motions and the memoranda submitted by the parties, and the arguments made in open court, and having taken the matter under advisement, the Court enters the following decision:

BACKGROUND

During its 2003 General Session, the Utah Legislature passed the Utah Venture Capital Enhancement Act ("the Act"), Utah Code Ann. §§ 9-2-1901, et seq., which was designed to enhance Utah's economy by encouraging investment and providing a vehicle to increase start-up capital for the development of local companies. As alleged in the complaint for declaratory and injunctive relief filed in this matter, since enactment, the Act has not been implemented according to the legislature's plan, because Defendants have refused "to (a) adopt procedures, criteria and policies . . . as mandated in the Act or (b) authorize, as required by the Act, the issuance of certificates to designated investors." The complaint also alleges, and by its answer and counterclaim for declaratory relief the Board confirms, that the Defendants have failed to take action required under the Act because Defendant Johnson believes that the Act is unconstitutional and the Board

believes the Act may be unconstitutional. No genuine factual issues over material facts exist because the dispute is really one between divergent points of view on the legal question of whether the Act is constitutional. While defendants point to some factual disputes, the court concludes they are not over material facts that prohibit the entry of summary judgment. Accordingly, as only issues of law are present, summary judgment is appropriate.

THE UTAH VENTURE CAPITAL ENHANCEMENT ACT

Upon finding that increasing venture equity capital investing through increasing the availability of such investment opportunities would "create new jobs in the state, and help to diversify the state's economic base" the legislature enacted the Utah Venture Capital Enhancement Act to:

> (a) mobilize private investment in a broad variety of venture capital partnerships in diversified industries and locales;
>
> (b) retain the private-sector culture of focusing on rate of return in the investing process;
>
> ©) secure the services of the best managers in the venture capital industry, regardless of location;
>
> (d) facilitate the organization of the Utah fund of funds to seek private investments and to serve as a catalyst for those investments by offering state incentives for private persons to make investments in the

> Utah fund of funds;
>
> (e) enhance the venture capital culture and infrastructure in the state so as to increase venture capital investment within the state and to promote venture capital investing within the state; and
>
> (f) accomplish the purposes referred to in Subsections 2(a) through 2(e) [above] in a manner that would maximize the direct economic impact for the state.

Utah Code Ann. § 9-2-1902(2).

In furtherance of these ends, the Act created the Utah Capital Investment Board (Utah Code Ann. § 9-2-1904), and the Utah Capital Investment Corporation, which was conceived and denominated as an "independent quasi-public nonprofit corporation" (Utah Code Ann. § 9-2-1907). Under the Act, the corporation was required to organize the Utah fund of funds as either a private limited liability company or a limited partnership with the corporation as general partner or manager (Utah Code Ann. § 9-2-1913). The Utah fund of funds is the investment tool designed to "encourage the availability of a wide variety of venture capital in the state;" to "help business in the state gain access to sources of capital;" and "to help build a significant, permanent source of capital available to serve the needs of businesses in the state" in a way that minimizes the use of contingent tax credits. Utah Code Ann. § 9-2-1913(2).

DISCUSSION

The Board has taken a rather interesting position in this case. At oral argument and in its brief the Board basically indicated it "wants" the Act to be constitutional, but has concerns about whether the Act is indeed constitutional. The Board is concerned that the statutory scheme makes the State a surety or guarantor, thus the Act may be in violation of Art. VI, Sec. 29 of the Utah Constitution. Based on the position of the Auditor, the Board seemingly has not acted under the Act. The Board basically is in agreement with the Corporation factually, and in terms of a belief in the constitutionality of the Cat, but argued in essence that the Act is not constitutional, especially as it relates to the State being a surety and thus the State is lending its credit in violation of the constitution. The court does not fault any party for their positions, as it is a very complex series of issues, at least to the court.

Quasi-Public Corporations

The Independent Entities Act, § 63E-1-101, et seq., provides that "'Quasi-public corporation' means an artificial person, private in ownership, individually created as a corporation by the

state which has accepted from the state a grant of a franchise or contract involving the performance of a public purpose relating to the state or its citizens." Utah Code Ann. § 63E-1-102(8). In contrast, "'Public corporation' means an artificial person, public in ownership, individually created by the state as a body politic and corporate for the administration of a public purpose relating to the state or its citizens." Utah Code Ann. § 63E-1-102(7).

While the parties disagree whether the Corporation and the Utah fund of funds are in fact "quasi-public" entities, or private or public entities, it is enough for purposes of this discussion that they are designed to serve a public purpose---the one element both a public and quasi-public entity share in common.

In the opinion of the Court, the key elements of the argument regarding the constitutionality of the Act are not greatly furthered by contending that the element of private or public ownership makes a difference in the analysis of whether the Act unconstitutionally permits the lending of the State's credit, or subscription to stock. While Johnson contends that because the entities created by the Act are public, because they were created by special act, the monies they receive are of necessity public, and thus, the prohibition against investment of "public funds" is violated by the Act, the Court disagrees, as set forth in more detail below.

Constitutional Prohibition Against Lending of State's Credit

Section 29 of Article VI of the Utah constitution prohibits the Legislature from authorizing "the State . . . or other political subdivision of the State to lend its credit or subscribe to stock or bonds in aid of any . . . private individual or corporate enterprise or undertaking." Both clauses of this section have been analyzed in Utah Technology Finance Corp. V. Wilkinson, 723 P.2d 406 (Utah 1986). Here, the Act ostensibly attempts to avoid violating this provision by stating "[t]he corporation may not: . . . pledge the credit or taxing power of the state or any political subdivision of the state." Utah Code Ann. § 9-2-1907(3)©). While such pronouncements do not fully eliminate Johnson's' interpretation under §29 of Article VI, further analysis of decisions interpreting the constitutional prohibition casts light upon the matter. According to Johnson, it is not a direct pledge of the State's credit which is the concern; rather, the actions sanctioned by the statute bear disconcerting resemblance to such prohibition, hence the claim of constitutional infirmity. Under Utah Technology Finance Corporation v. Wilkinson, 723 P.2d 406 (Utah 1986), the relevant inquiry distilled from the authorities cited by the Supreme Court is whether under the challenged legislation "the state is . . . empowered to become a

surety or guarantor of another's debts." Id., at 412. Johnson contends, and the Board is concerned, that the statute empowers the State in this manner because the Act's provisions allow the Board to issue tax credits---and even refundable credits since House Bill 179 was passed in the 2005 General Session---sufficient to ensure that investors in the Utah fund of funds, which the corporation manages, are guaranteed a certain rate of return. If that rate is not met, a refund of cash will be made, thus making the State s surety or guarantor. The argument follows, then, that the forgiveness of tax liability is in a sense "paying" public tax revenue, or as it might be said, pledging the State's taxing power, to meet the obligation to the investors.

The key to the analysis here, however, is to determine to which entity the debt belongs. If it is the debt of the State, then the use of tax revenue would not be an impermissible lending of the State's credit. If, on the other hand, the debt belongs to another, then the use of tax funds would be improper. It seems to the Court that this determination cannot be properly made unless the Court looks to whether the State is promising to pay any deficiency, or whether it is the obligation of some other entity---such as the private enterprises in which the Utah fund of fund monies are to be invested. In analyzing the question in this manner, it is necessary to know how the money is to be used. If

the money is to be merely loaned to the enterprises, who by contract must then repay the amounts loaned with interest, then the Board's offer to "pay" the investors the difference between the amount targeted and the actual return in the form of tax credits, then the State is impermissibly acting as a surety on the loan of another. However, "venture capital" is defined as "money made available for investment in innovative enterprises or research, especially in high technology, in which both the risk of loss and the potential for profit may be considerable." The American Heritage Dictionary 1982 (Third Edition 1996). It is simply not a loan. As with other types of investments which are not loans, there is no contractual guaranty that the money invested will be returned with a profit. Thus, if any guaranty exists, it is an original promise and obligation. In this instance, by offering tax credits as one mechanism to guaranty an investor a certain rate of return on his or her investment, the State has made an original guaranty---in a sense, a potential debt---to the investor. In so doing, it is apparent that the legislature, by imbuing the Board with the authority and discretion to determine how much return is to be guaranteed, believed that the benefit to the State identified in the statute was worth the risk of loss. As noted in cases considering this issue, that determination is indeed a legislative, not a judicial, function.

A second test to determine whether there is a lending of credit is to examine whether the statute requires some new financial liability upon the state, that is, whether it creates a new debt. If in some eventuality the state may be required to pay the obligation of a private enterprise, that may be sufficient to amount to a lending of credit. If the board issues contingent tax credits, the court believes it is not creating and undertaking a new debt. If the State redeems those credits it is honoring its promise to give a tax credit. This amounts to really foregoing tax revenue, rather than creation of a debt.

Thus, the tax credit is not an unconstitutional lending of the State's credit, but rather, a constitutional investment, by the legislature, of funds for what has been identified by the Legislature as a legitimate public purpose.

The court agrees with the auditor that having a public purpose does not alone save the Act. It is a necessary but not a sufficient condition. Here, as noted, there are clearly legislatively determined public purposes which the court cannot second guess.

As to the Board's position, the court concludes its concerns, while perhaps well founded and certainly well-intentioned, its arguments for its "inaction" are not well founded. This is particularly so given that part of the Board's argument focuses on

legislation from the general session of 2005, yet the "inaction" of the Board has been (not) occurring since passage of the Act.

Constitutional Prohibition Against Stock Subscription

In only one Utah case has the Utah Supreme Court found an unconstitutional subscription of stock. In Utah Technology Finance Corp., v. Wilkinson, supra, the Supreme Court noted: "In none of the thirteen cases which have been appealed to this Court involving section 29 [of Art. VI] has there been a subscription by the state or its political subdivisions to stocks or bonds in aid of any private enterprise." Id. at 413. The Court then went on to hold that, notwithstanding the legislature's finding of a legitimate public purpose for the use of public funds to match private investment in stock, it was nonetheless an impermissible subscription to stock as public funds were directly committed to purchase a limited partnership interest. Justice Zimmerman, concurring, noted that section 29 contains two narrow express prohibitions. He asserts that an expansive reading of the two clauses in section 29 is not justified and that a public purpose carries weight, though it may not overcome a direct violation of that section.

In the present case, there is no direct funding from public sources for the purchase of stock. The statute does not provide

for the purchase of stock by the Board using public monies. It is telling that the statute at issue here is distinct from the statute at issue in the Wilkinson, the only case in which a statutory scheme has been found to be in violation of the subscription of stock prohibition. The money in the present case is entrusted to the Utah fund of funds and the Corporation to invest in concerns in such a manner as to benefit the State. The use of state resources as outlined in the Act, in accomplishing the public purposes stated in the Act, is not a subscription of stock, but an investment for the public benefit. It facilitates the private investment in those enterprises which the legislature has found to be beneficial to state interest.

The court need not and does not decide whether Art. XIII sec. 4 allows this Act in spite of other constitutional prohibitions. The court concludes the Act does not violate the provisions of Art. VI, sec. 29. Combine that conclusion with the strong presumption of constitutionality, and the policies of Art. XIII, sec. 4, and the court believes the purposes of the legislature are fulfilled without offense to any constitutional provision. Further, there are clearly public benefits involved and while those do not allow any and all enactments by the legislature, a public policy and benefit enables all but clear violations of other constitutional prohibitions on legislative action.

Tax credits, contingent at that, are different from credit or payment of money by a state. The court does not see a contingent tax credit as an extension of credit. Art. XIII sec. 4 allows the legislature to grant tax offsets, or credits. The court views this legislation as a legitimate effort at doing that.

CONCLUSION

Because the Act is neither an unconstitutional lending of the state's credit nor an unconstitutional subscription to stock, the Court concludes that the Act is constitutional, and Plaintiff's Motion for Summary Judgment is hereby GRANTED. The Board is enjoined from failing or refusing to under take the statutory obligations under the Act.

The motion of Johnson for summary judgment is DENIED.

All parties herein are very well represented. The issues are complex and close. The arguments of all parties were well presented but the court believes the Act is constitutional and not a lending of credit nor a subscription of stock.

Plaintiff is to prepare an order reflecting this ruling in

compliance with Rule 7(f), URCP.

DATED this 20 day of May, 2005.

Judge Bruce C. Lubeck
District Court Judge

CERTIFICATE OF NOTIFICATION

I certify that a copy of the attached document was sent to the following people for case 040923031 by the method and on the date specified.

METHOD	NAME
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Dated this 20 day of May, 2005.

Deputy Court Clerk